IN THE

Supreme Court of the United States

October Term, 1971

No. .....

Supreme Court, U.S.
FILED
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E. ROBERT SEAVER, CLERK

71-852

C. D. CONSTRUCTION CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

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C. D. CONSTRUCTION CORPORATION,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

The petitioner, C. D. Construction Corporation, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit entered in this proceeding on November 30, 1971.

Opinions Below.

The opinion of the court below is not yet officially reported but it appears in the Commerce Clearing House "USTC" reports at 71-2 USTC ¶9772. It is given in full in the Appendix, *infra*, beginning at p. 1 thereof.

The memorandum findings of fact and opinion of the Tax Court were officially reported as T. C. Memo 1970-297. The portions thereof pertinent to the issue appealed are given in the Appendix, *infra*, beginning at p. 6 thereof.

This is a transferee case. There were prior proceedings in which the taxpayer's liability for the tax involved was litigated. The decision therein of the court below, *Charles Town, Inc. v. Commissioner*, 372 F.2d 415, cert. denied, 389 U.S. 841 (1967), is referred to by that court herein at footnote 2 of its opinion, p. 2 of the Appendix, *infra*. The decision of the Tax Court therein was officially reported as T. C. Memo. 1966-15 and appears in the Commerce Clearing House "TCM" reports at 25 TCM 77. Pertinent excerpts from that decision, and of its affirmance by the court below, are included in the Appendix, *infra*, beginning at p. 35 thereof.

Jurisdiction.

The judgment of the Court of Appeals was entered on November 30, 1971. The jurisdiction of this Court is based on 28 U.S.C. §1254(1).

Question Presented.

The question presented is whether under the facts as found by the Tax Court the petitioner is liable, as a transferee of a transferee of Charles Town, Inc., a West Virginia corporation, hereinafter referred to as Charles Town, for the tax liability of Charles Town previously determined by the Tax Court, and officially reported by it, as shown above, as T. C. Memo. 1966-15. The intermediate transferee is Fairmount Steel Corporation, a Pennsylvania corporation with its main office in Maryland, hereinafter referred to as Fairmount. As shown in the opinion of the court below, we agree that petitioner would be liable, in an amount also agreed, if Fairmount was liable as transferee of Charles Town for the said tax liability determined against Charles Town.

Statutes Involved.

The transferee provision, as cited by the court below, is 26 U.S.C. §6901(a)(1)(A)(i), which provides as follows:

> "(a) METHOD OF COLLECTION.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:
>
> (1) INCOME, ESTATE AND GIFT TAXES.—
>
> (A) TRANSFEREES.—The liability, at law or in equity, of a transferee of property—
>
> (i) of a taxpayer in the case of a tax imposed by subtitle A (relating to income taxes)."

As to the liability "at law" of Fairmount as a transferee of Charles Town, both the Tax Court and the court below correctly point to the law of West Virginia, §40-1-3, which provides as follows (App. 3-4, 27-28):[1] 3-4). In doing so it relied on an issue never raised by

> "Every transfer or charge which is not upon consideration deemed valuable in law shall be void as to creditors whose debts shall have been contracted at the time it was made; but shall not, upon that account merely, be void as to creditors whose debts shall have been contracted, or as to purchasers who shall have purchased, after it was

[1]The "App." references are to the pages of the appendix hereto, without regard to the page numbers in the source.

made; and though it be decreed to be void as to a prior creditor because voluntary, it shall not for that cause be decreed to be void as to subsequent creditors or purchasers."

The court below relied also on the liability of Fairmount as a liability of a transferee "in equity" (App. 3-4). In doing so it relied on an issue never raised by respondent in the trial court, that is, the Tax Court, or considered by that court.

The liability of Charles Town was determined by the Tax Court solely under section 482 of the Internal Revenue Code of 1954 (App. 37). That determination was affirmed by the court below also solely on the basis of that section (App. 35-36). In this transferee proceeding the Tax Court considered the effect of that section (App. 30). It is impossible to understand why in this transferee proceeding the court below takes the wholly unusual step of not even mentioning it. That section reads as follows:

"In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

Statement.

The court below correctly states, to the extent to which it states them, the facts of the Charles Town and Fairmount operations involved here. We quote (App. 2):

> "Charles Town is an empty corporate shell and owes back income taxes for the years 1958 and 1959 in the total amount of $375,984.50. Charles Town was incorporated under the laws of West Virginia and issued 100 shares of common stock for a total consideration of $1,000. Charles Town operated two horse racing meets in West Virginia, one in the summer of 1958 and one in the winter of 1958-1959, with funds supplied by Fairmount Steel Corporation. Fairmount had agreed by contracts to advance to Charles Town all of the funds necessary for the operation of the meets and to bear any resulting losses in return for receiving 90 percent of the profits from the meets. Fairmount's advances to Charles Town were not evidenced by any notes or other debt instruments, were made without security, were made without agreement as to a repayment date, and were not repayable at all to the extent that losses were incurred in the meets. In 1958 and 1959 Fairmount was reimbursed for its advances of $986,525 and received 90 percent of the racing profits, $732,299.86. On June 30, 1962, Fairmount liquidated, transferring without consideration its assets of $253,394.40 to C. D. Construction."

There are also certain other significant facts shown by the Tax Court's findings. Each of the two horse racing meets, the first lasting 11 weeks and the second, 7

weeks, was under a separate contract between the two corporations, a separate lease of the race course, and a separate license from the Racing Commission. (App. 11, 13, 16). Each contract was not just for horse racing but for the particular horse racing meet. Under each contract, furthermore, the monies provided and generated were characterized in relation to Fairmount as "its monies." (App. 14-16). And the Tax Court appears to concede that they "belonged" to Fairmount, except "temporarily." (App. 31). As to Charles Town's stock, while, as noted above, its issued stock totaled only $1,000, its *authorized* stock totaled only $10,000 (App. 36). In its application for license to conduct each meet it stated that the funds to be used for that purpose would be furnished by another, named corporation, Fairmount (App. 36-37).

The Commissioner made his determination against Charles Town of the taxes involved here by deficiency notice issued June 11, 1962. That notice asserted those taxes under "sections 61 and 482" of the Internal Revenue Code of 1954 (App. 7, 22). There is no evidence of any prior knowledge of Charles Town that these additional taxes would, or would probably, be asserted.

As the sole basis for its conclusion that Fairmount was liable "in equity" for Charles Town's taxes, the court below stated:

> "The Tax Court correctly found that Fairmount was in substance a stockholder of Charles Town and, by implication, that the transfer of racing proceeds from Charles Town to Fairmount was a corporate distribution." (App. 3).

The Tax Court, however, made no such finding. It did find, correctly, that Fairmount's advances constituted "in substance an equity investment." (App. 37). Clearly they were an equity investment in, a contribution of capital to, a single, specific, horse racing meet—the meet itself, not Charles Town, the corporate entity. The Tax Court did not find otherwise; it definitely did not find that Fairmount was "in substance a stockholder of Charles Town." And nowhere did either the court below, or the Tax Court, challenge the validity, the fairness, or the reasonableness, of either of the contracts between the two corporations. On the contrary, they relied upon them. We shall deal with this question of the relation between the two corporations again under Reasons for Granting the Writ.

REASONS FOR GRANTING THE WRIT.

1. A Review of This Case Will Be Helpful in Reaching a Conclusion in Another Case Now Pending in This Court.

As it will appear more fully below, especially under Reason 4, the decision herein of the court below is in conflict with decisions of other United States courts of appeals which are cited and relied on by the government in a proceeding now pending in this Court, *Commissioner of Internal Revenue v. First Security Bank of Utah*, docket 70-305. As it accordingly follows, we support the government in that case. Although we do not depend on the issue involved there alone, we suggest that a review of our case will be helpful in reaching a conclusion there.

2. The Decision Below Is in Conflict With the Decision of This Court in Commissioner v. Stern, 357 U.S. 39 (1958), and Other Cases Holding, as Observed by the Tax Court Herein (App. 25), That in Determining Who Is Liable as a Transferee, Applicable State Law Is Controlling.

As noted above the court below held that Fairmount's advances constituted it "in substance" a shareholder in Charles Town; the court below therefore concluded that the monies derived by Fairmount from each racing meet were corporate distributions and without consideration. There is, however, no authority under West Virginia law, or indeed the law of any other state, holding that where one corporation carries out a specified operation with funds furnished by a second corporation, under a specific, valid, fair and reasonable contract, that the furnishing of the funds by the second

corporation is "in substance" a purchase of stock by the second corporation in the first.

Especially this could not be so where the funds furnished by the first corporation; as here, total $986,525, and the total *authorized* stock of the second corporation amounts to only $10,000. It is stated in 11 Fletcher, Cyclopedia of Corporations, 1971, Chapter 58, §5082:

> "It is essential, of course, to the existence and validity of stock, that it shall be duly authorized. . . . Its actual capital stock is the amount of its authorized capital that has been bona fide subscribed for and paid in."

See also 11 Fletcher, §5085, and 18 C.J.S., Corporations, ¶477.

We do not say that substance may not override form. But here is a contract, with detailed terms, for carrying out a very specific operation of very short duration. And under the law of the state here, a contract between a corporation and a person controlling it is binding as a contract if it is fair. The fairness is its chief essential ingredient. Where it is fair, payments by the corporation under it are not voluntary but for consideration. *Hope v. Salt Co.*, 25 W. Va. 789, 799; *Coal Sales Co. v. Coal Co.*, 105 W. Va. 610, 617.

There is also no similarity here to the terms of a stock certificate, or the provisions of state law governing the rights and obligations of shareholders, as such. As noted above, this issue of stockholding "in substance" was not raised here in the trial court. Whether evidence on it might have been offered if the issue had been raised there is not clear. In any case, the law of the state is clear, and under that law, Fairmount was not

"in substance" a shareholder of Charles Town. It is that law, the law of the state, which governs. As indicated above, so this Court has held.

We submit on this issue that the decision below is plainly in conflict with the rule as so stated by this Court and should be reviewed.

3. The Decision Below Is in Clear Conflict With the Decision of the Court of Appeals for the Ninth Circuit in Maple et al. v. Commissioner, 440 F.2d 1055.

The court below, in reaching the conclusion that the payments received by Fairmount out of the racing proceeds were "not upon consideration deemed valuable in law," makes the assumption that Charles Town in form and in substance operated each of the two racing meets. But Fairmount, as observed by the court below, agreed by contracts to advance "all of the funds necessary for the operation of the meets and to bear any resulting losses in return for receiving 90 percent of the profits from the meets." (App. 2). Where such a risk is taken by one person, the operation by a second person under contract is in substance operation by the first. *Maple et al. v. Commissioner, supra,* at p. 1057. To say then that the monies Fairmount received under each contract, in accordance with the contract, were received by it, as the court below held, without consideration, is simply and directly to contradict the Tax Court's findings, as set forth by the court below itself. And the burden of proof here was upon respondent. *Healy v. Commissioner,* 345 U.S. 478.

We submit, therefore, that the decision herein below is in conflict with the decision of the Ninth Circuit in *Maple, et al. v. Commissioner, supra.*

4. The Decision Below, in Treating the United States, in Respect of a Tax Liability Determined Under 482 of I.R.C. 1954, as a Creditor Here, Before the Liability Is Asserted by the Commissioner, Is in Conflict With Decisions of the United States Courts of Appeals for Several Circuits, Including Decisions Relied on by the Petitioner in Docket No. 70-305 Now Pending in This Court.

The decisions above referred to are as follows:

C.A.2—*Rubin v. Commissioner*, 429 F.2d 650;

C.A.3—*National Securities Corporation v. Commissioner*, 137 F.2d 600;

C.A.7—*G.U.R. Co. v. Commissioner*, 117 F.2d 187;

C.A.6—*Interstate Fire Insurance Company v. U.S.*, 339 F.2d 603;

C.A.7—*Erna B. Zeddies et al. v. U.S.*, 357 F.2d 897.

Here the Commissioner, as noted in the Statement above, in determining the deficiency against Charles Town, cited as his basis "sections 61 and 482" of the Internal Revenue Code of 1954. Section 61 is the general provision on gross income. The standard under it, as the section itself reads, is the income "derived" by the particular taxpayer from the "source" of the income. Section 482 is a special provision clearly beyond Section 61 and relating only to commonly controlled taxpayers. The standard under it for determining the income of each of such taxpayers is, regardless of the income "derived" by it from the "source" of the incomes, allocation to it of a share of the common income such as it would be if it were "that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer." Treasury Regulations, §1.482-1(b)(1), as

quoted by the petitioners in docket 70-305 now pending in this Court, at p. 14 of its opening brief. Thus, in the *Rubin* case, *supra*, it was held by the Second Circuit, at p. 653, reversing the Tax Court, that where section 482 is applicable, section 61 has no place. Similarly, in the *National Securities* case, *supra*, at p. 602, it was held by the Third Circuit that the section under prior revenue acts corresponding to section 482 was wholly superfluous except as applicable to the broad area of allocation of income which could not be reached by the sections under those acts corresponding to section 61.

Thus here in the proceeding involving the taxpayer, Charles Town, while sections 61 and 482 could be asserted by the Commissioner in his deficiency notice as alternative positions, the affirmance by the Tax Court and the court below solely on the basis of section 482 rules out section 61 altogether. But section 482 is wholly discretionary with the Commissioner; only he can apply it, the taxpayer cannot. Treasury Regulations, §1.482-1(b)(3); 7 Mertens §38.61 at fn. 95; *G.U.R. Co. v. Commissioner, supra.* And because of the breadth of the Commissioner's power under that section, which he alone can apply, the allocations under it must be upheld unless unreasonable, arbitrary or capricious. *Wisconsin Big Boy Corp. v. Commissioner* (C.A. 7), Nov. 23, 1971, 71-2 USTC ¶9755; *Braun Co., Inc. v. Commissioner* (C.A. 2), 396 F. 2d 264, 266.

Thus it follows from the decisions above cited that a tax determined, as here, under section 482 is not self-assessing. For that reason it was held as follows, in *Interstate Fire Insurance Company v. U.S.*, 215 F. Supp. 586, 598, affirmed "in all things" and for "the

reasons set forth therein," C.A. 6, 339 F.2d 603: "The use and application of section 482 does not result in an enforcible tax consequence until there has been a reallocation resulting in a reassessment of taxes."

As a result the tax involved here did not become a liability until it was determined by the Commissioner. In *Erna B. Zeddies et al. v. United States, supra,* at p. 899, it was held by the Seventh Circuit that to sustain the transferee liability involved there it had to be established that the conveyance "directly tended to or did impair the rights of the United States as a creditor *at the time of the conveyance.*" (Italics supplied.) The rights of the United States as a creditor did not arise here, as shown in the Statement above, until June 11, 1962, in the form of the issuance of the deficiency notice against Charles Town, more than three years after the payments out of the racing proceeds were received by Fairmount.

This is a wholly different situation, even assuming the impossible, that Fairmount's advances were payments for stock, from that in *Neill v. Phinney,* (C.A. 5) 245 F.2d 645, quoted by the court below at length. The situation there involved distributions to actual shareholders. Moreover, those distributions occurred very shortly before the retroactive tax involved was enacted, and when that tax was already well along in process in Congress and had been widely publicized. As a result, it was clearly to be anticipated because of existing facts. But above all, the payments there were not made as here under an express and binding contract, the fairness of which has not been questioned.[2]

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[2]Though the fairness of the contract here has not been questioned, we cite, by way of additional support, a similar race

(This footnote is continued on next page)

Thus the decision below, by disregarding though relying on the contract involved; disregarding the absence of any challenge to the fairness and reasonableness of the contract, and disregarding the nonexistence of the tax liability, at the time the payments under the contract were made, because requiring assertion of that liability by the Commissioner, is in clear conflict with the Sixth Circuit in *Interstate Fire Insurance Company v. U.S., supra*, and the Seventh Circuit in *Erna B. Zeddies, et al. v. United States, supra*, as well as with the several cases cited above relied on by the petitioner in the First Security case now pending in this Court, No. 70-305.

5. The Decision Below Is Also in Conflict With Cases Involving Taxes Which Are Likewise Not Self-Assessing, But Under Other Sections of the Internal Revenue Code Than Section 482.

An example of such a case is *Ray E. Loper Lumber Co. Inc. v. U.S.* (C.A. 6) June 24, 1971, 444 F.2d 301, where the Court stated: "For the reasons hereinabove stated, and particularly because the tax is not self-assessing, we interpret §§531-35 as giving rise to accumulated earnings tax liability only after the Commissioner has given notice and demand for payment." The same conclusion was reached in *Motor Fuel Carriers, Inc. v. U.S.* (C.Cls.) 420 F.2d 702.

For the same reason a tax determined under section 482, as concluded by the Sixth Circuit in *Interstate Fire Insurance Company v. U.S., supra*, is not a li-

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track situation where the parties were clearly at arm's length and there was the same percentage as here to the operating entity: *Boys Incorporated of America v. Campbell* (N.D. Tex. 1966), 66-2 USTC ¶9533, 18 AFTR 2d 5200, Findings 11, 27.

ability until it is in fact determined by the Commissioner. Thus the decision below herein, in holding United States a prior creditor under the West Virginia code, is in conflict with the Sixth Circuit in *Ray E. Loper Lumber Co., Inc. v. U.S., supra,* and the Court of Claims in *Motor Fuel Carriers, Inc. v. U.S., supra.*

Conclusion.

Because of the conflicts shown above with decisions of this court and of the courts of appeals of other circuits, and of the pendency now in this court of another case, No. 70-305, involving the same section of the Internal Revenue Code in a manner basic to the question here, we urge that this proceeding be accepted for review.

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STANLEY H. WILEN,

APPENDIX.

Opinion of the Court of Appeals for the Fourth Circuit in This Proceeding.

United States Court of Appeals, for the Fourth Circuit.

C. D. Construction Corporation, Appellant, *versus* Commissioner of Internal Revenue, Appellee. No. 71-1321.

Appeal from the Decision of the United States Tax Court.

John W. Kern, Judge.

(Argued October 7, 1971, Decided November 30, 1971.)

Before BOREMAN, Senior Circuit Judge, and CRAVEN and RUSSELL, Circuit Judges.

George T. Altman (Stanley H. Wilen on brief) for Appellant, and Richard Farber, Attorney, Department of Justice, (Johnnie M. Walters, Assistant Attorney General, Meyer Rothwacks, Richard W. Perkins, Attorneys, Department of Justice, on brief) for Appellee.

CRAVEN, Circuit Judge:

This is an appeal from a decision of the Tax Court that C. D. Construction Corporation is liable as a transferee for unpaid federal income taxes of Charles Town Corporation under 26 U.S.C.A. § 6901(a)(1)(A)(i).[1] We affirm.

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[1] 26 U.S.C.A. § 6901(a)(1)(A)(i):

(a) Method of collection.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) Income, estate, and gift taxes.—

(This footnote is continued on next page)

Briefly, the facts are these:[2] Charles Town is an empty corporate shell and owes back income taxes for the years 1958 and 1959 in the total amount of $375,984.50. Charles Town was incorporated under the laws of West Virginia and issued 100 shares of common stock for a total consideration of $1,000. Charles Town operated two horse racing meets in West Virginia, one in the summer of 1958 and one in the winter of 1958-1959, with funds supplied by Fairmount Steel Corporation. Fairmount had agreed by contracts to advance to Charles Town all of the funds necessary for the operation of the meets and to bear any resulting losses in return for receiving 90 percent of the profits from the meets. Fairmount's advances to Charles Town were not evidenced by any notes or other debt instruments, were made without security, were made without agreement as to a repayment date, and were not repayable at all to the extent that losses were incurred in the meets. In 1958 and 1959 Fairmount was reimbursed for its advances of $986,525 and received 90 percent of the racing profits, $732,299.86. On June 30, 1962, Fairmount liquidated, transferring without consideration its assets of $253,394.40 to C.D. Construction. The parties agree that C. D. Construction is liable as a transferee under 26 U.S.C.A. § 6901(a)(1)(A)(i)

(A) Transferees.—The liability, at law or in equity, of a transferee of property—

(i) of a taxpayer in the case of a tax imposed by subtitle A (relating to income taxes), . . .

[2] For a full factual background of this dispute see Charles Town, Inc. v. Commissioner, 372 F.2d 415 (4th Cir.), *cert. denied*, 389 U.S. 841 (1967).

for the unpaid income taxes of Charles Town (to the extent of the assets it received from Fairmount) if Fairmount was liable as a transferee under 26 U.S.C.A. § 6901(a)(1)(A)(i) because of having received the racing proceeds generated by Charles Town.[3] The Tax Court held that Fairmount was liable, and, therefore, that C. D. Construction is liable for Charles Town's unpaid taxes to the extent of $253,394.40.

The Tax Court correctly found that Fairmount was in substance a stockholder of Charles Town and, by implication, that the transfer of racing proceeds from Charles Town to Fairmount was a corporate distribution. Fairmount, therefore, was liable for Charles Town's taxes "in equity" under 26 U.S.C.A. § 6901(a)(1)(A)(i):

> [T]he parties . . . lost sight of the universal rule. Under it stockholders in dissolution are not ordinary transferees of corporate property as might, for example, be the case of a purchaser of a specific piece of its property as to whom a convey-

[3]C. D. Construction received the assets of Fairmount without consideration and would, therefore, be liable "in law" under 26 U.S.C.A. § 6901(a)(1)(A)(i), *supra* n. 1, by operation of W. Va. Code Ann. § 40-1-3:

> § 40-1-3. Voluntary transfers or charges.
>
> Every transfer or charge which is not upon consideration deemed valuable in law shall be void as to creditors whose debts shall have been contracted at the time it was made; but shall not, upon that account merely, be void as to creditors whose debts shall have been contracted, or as to purchasers who shall have purchased, after it was made; and though it be decreed to be void as to a prior creditor because voluntary, it shall not for that cause be decreed to be void as to subsequent creditors or purchasers.

> ance carries a quasi *in rem* liability only when in fraud of creditors. Stockholders in distribution have not purchased property. They receive only an aliquot share of property. The right to receive it flows from the accumulation of it in excess of the obligations owed and by which assets, in this or other forms, have been accumulated. Such stockholders receiving property in distribution hold it subject to pro rata liabilities of the corporation. [Citations omitted.] The stockholders hold what they get subject to an equitable lien. "The capital and assets of a corporation constitute a trust fund, for the benefit and security of its creditors, and it is fundamental that stockholders, stripping a corporation of its assets, succeed as transferees to its tax liability. [Citations omitted.]" It is, then, by an ageless principle a liability imposed "in equity," . . .

Neill v. Phinney, 245 F.2d 645, 651-52 (5th Cir. 1957).

Fairmount was also liable for Charles Town's taxes "at law" under 26 U.S.C.A. § 6901(a)(1)(A)(i). According to the applicable West Virginia statute,[4] Fairmount was liable for Charles Town's taxes if the transfer of the racing proceeds was "not upon consideration deemed valuable in law." There was no consideration for the transfer. Fairmount's assumption of the risk of loss was not consideration within the meaning of the statute; it was simply a risk that is borne by every stockholder to the extent of his investment.

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[4]Set out in note 3 *supra*.

Fairmount's right to receive 90 percent of the racing profits was not consideration for the use of the money advanced as it would have been had the advances to Charles Town been loans. The right was reasonably viewed by the Tax Court as a right to receive dividends based on capital contribution. Because Fairmount was a stockholder, its right to *any* corporate income was subject to the corporation's liabilities, including the government's claim for taxes due on the income.

For the reasons stated above and for the further reasons stated in the decision of the Tax Court, T.C. Mem. 1970-297; ..... T.C. ..... (1970), the judgment below is

Affirmed

Findings and Opinion of the Tax Court in This Proceeding.

United States Tax Court.

Charlotte C. Weinberg Trust, Herman Cohen, Zelda G. Cohen and Jacob Kartman, Trustees, et al.,[1] Petitioners v. Commissioner of Internal Revenue, Respondent. T. C. Memo 1970-297.

Docket Nos. 2577-68, 2578-68, 2579-68, 2580-68, 2581-68, 2582-68, 2583-68, 2584-68, and 2585-68. Filed October 22, 1970.

Stanley H. Wilen and *George T. Altman*, for the petitioners.

Charles F. T. Carroll and *William Morris*, for the respondent.

Respondent has asserted transferee liability against each of the petitioners in these consolidated cases in the amounts set out below, plus interest as provided by law:

Petitioner-Transferee	Docket Number	Amount
Charlotte C. Weinberg Trust, Herman Cohen, Zelda G. Cohen, and Jacob Kartman, Trustees	2577-68	$112,500.00
Rosa L. Cohen	2578-68	375,984.50
C. D. Construction Corporation	2579-68	253,394.40
Charlotte C. Weinberg	2580-68	25,339.44
Ben Cohen	2581-68	375,984.50
Herman Cohen	2582-68	375,984.50
Zelda G. Cohen	2583-68	375,984.50
Rosalee C. Davidson	2584-68	137,839.44
Nathan L. Cohen	2585-68	275,678.88

[1] Cases of the following petitioners are consolidated herewith: Rosa L. Cohen, docket No. 2578-68; C. D. Construction Corporation, docket No. 2579-68; Charlotte C. Weinberg, docket No. 2580-68; Ben Cohen, docket No. 2581-68; Herman Cohen, docket No. 2582-68; Zelda G. Cohen, docket No. 2583-68; Rosalee C. Davison, docket No. 2584-68; and Nathan L. Cohen, docket No. 2585-68.

These determinations of transferee liability represent deficiencies in income taxes of a corporation, Charles Town, Incorporated (hereinafter sometimes referred to as "Charles Town") for the taxable period May 22, 1958 to November 30, 1958, and for the fiscal year ended November 30, 1959 in the amounts of $258,616.93 and $117,367.57, respectively. These deficiencies in income taxes correspond to deficiencies determined by the respondent in a statutory notice of deficiency mailed to Charles Town on June 11, 1962, wherein respondent increased Charles Town's reported net income by determining that certain income and deductions related to the conduct of two horse racing meets and reported in income tax returns of Fairmount Steel Corporation (hereinafter sometimes referred to as "Fairmount") were instead income and deductions of Charles Town under the provisions of sections 61 and 482, I.R.C. 1954.[2] These deficiencies were sustained in subsequent litigation, *Charles Town Inc.*, T.C. Memo. 1966-15, affirmed 372 F. 2d 415 (C.A. 4, 1967), cert. denied 389 U.S. 841 (1967). . . .

Since the deficiencies due from Charles Town have been established in the litigation mentioned above, at issue is whether petitioners, or any of them, are liable, and if so to what extent, as transferees of Charles Town. . . .

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[2]Hereafter all statutory references are to the Internal Revenue Code of 1954, unless otherwise indicated.

FINDINGS OF FACT

Some of the facts and exhibits have been stipulated and are incorporated herein by this reference. . . .

Petitioner C. D. Construction Corporation is a corporation which had its principal office at 1229 Mount Royal Avenue, Baltimore, Maryland, at the time of the filing of the petition herein.

Charles Town, Incorporated was a corporation incorporated on May 22, 1958, under the laws of the State of West Virginia. Charles Town filed Federal corporation income tax returns for the taxable period May 22, 1958 to November 30, 1958, and for the fiscal year ended November 30, 1959, with the district director of internal revenue, Baltimore, Maryland.

Fairmount Steel Corporation was incorporated on July 5, 1951, under the laws of the State of Pennsylvania. Fairmount filed a Federal corporation income tax return for the taxable year ended June 30, 1959 with the district director of internal revenue, Baltimore, Maryland.

The issued and outstanding stock of Fairmount, at all times material hereto, consisted of Class A common stock and Class B common stock. The Class A common stock was issued for $1.00 per share as follows:

Ben Cohen	50 shares
Herman Cohen	50 shares

At all times material hereto, Ben Cohen and Herman Cohen have held all the issued and outstanding Class

A common stock of Fairmount. The Class B common stock was issued for $50.00 per share as follows:

Ben Cohen (younger brother of Herman)	175 shares
Herman Cohen (older brother of Ben)	175 shares
Herman Cohen, Ben Cohen, and Stanley Wilen, Trustees for Charlotte Cohen (daughter of Ben) now Charlotte Weinberg	100 shares
Rosalee Cohen (daughter of Ben) now Rosalee Davison (wife of Richard Davison)	100 shares
Jacob Kartman, Ben Cohen, and Rosa L. Cohen (wife of Herman), Trustees for Nathan L. Cohen (son of Herman)	200 shares
Raymond Voyes	250 shares

In March 1953, the shares of stock originally issued to Raymond Voyes were transferred to Cohen Brothers, a partnership, consisting of Herman Cohen and Ben Cohen. In 1957, the shares of stock originally issued to the aforementioned trustees for Charlotte Cohen, were distributed by said trustees to Charlotte Cohen, individually. There were no other changes in the ownership of the Class B common stock at any time material hereto, and the foregoing represented all the issued and outstanding Class B common stock.

The officers of Fairmount, from its inception and at all times material hereto, all of whom constituted the board of directors of Fairmount, were as follows:

President	Herman Cohen
Vice President and Secretary-Treasurer	Ben Cohen
Assistant Secretary-Treasurer	Rosa L. Cohen
Assistant Secretary-Treasurer	Zelda G. Cohen

In addition, in 1954, and at all times material thereafter, Richard Davison, the husband of Ben's daughter,

Rosalee, became an Assistant Secretary of Fairmount, although he did not serve as a director.

For a number of years, Ben and Herman Cohen and corporations and partnerships controlled by them or their families have engaged in numerous business enterprises. On numerous occasions funds were loaned or transferred by one of the Cohen enterprises to another.

In or about December 1954, Herman and Ben Cohen acquired controlling interest in the Maryland Jockey Club of Baltimore City, Inc. At or about the same time Louis Pondfield, a nephew of Herman and Ben, acquired an interest in the Maryland Jockey Club which eventually amounted to 7-1/2%. Since that time, the Maryland Jockey Club has owned and operated the Pimlico Race Course, Baltimore, Maryland. Pondfield was general manager of the Pimlico Race Course operations.

At various times dating back to the 1930's, Ben Cohen had been interested in acquiring the Charles Town Race Course in Charles Town, West Virginia (hereinafter sometimes referred to as the "Race Course"). Albert Boyle, owner of the Race Course, died in November of 1957. Subsequently Ben and Herman Cohen, together with Pondfield, engaged in negotiations with a representative of Boyle's widow, Harry Byrer, with regard to purchasing the Race Course. Pondfield had brought Mrs. Boyle's wish to sell the track to the Cohen's attention. After negotiations for a purchase of the Race Course failed, Ben Cohen successfully concluded negotiations with Byrer for the pur-

pose of leasing it. A lease agreement covering the term of a single summer racing meet and bearing the date May 20, 1958, was drafted between Helene W. Boyle and "Ben Cohen, acting for Charles Town, Incorporated, a corporation to be formed under the laws of the State of West Virginia." This lease was executed by Helene W. Boyle and Ben Cohen. On November 3, 1958, a second lease was executed covering the term of a 1958-1959 winter meet.

Charles Town was duly incorporated under the laws of the State of West Virginia on May 22, 1958. Its certificate of incorporation provided, in part, that the principal office of the corporation would be located at 1229 Mount Royal Avenue, Baltimore, Maryland, at which address was also located the offices of Ben and Herman Cohen. The corporate purpose and powers of Charles Town as stated in the certificate of incorporation had to do with "the business of operating a race track or race course in all of its branches." The issued and outstanding stock of Charles Town consisted of 100 shares of common stock issued as follows:

Issued To	No. of Shares
Herman Cohen	1
Ben Cohen	1
Louis Pondfield	98

The stock was issued for the total sum of $1,000.00 which was paid as follows:

Date Paid	Payor	Amount
July 22, 1958	Herman Cohen	$ 10.00
July 22, 1958	Ben Cohen	10.00
July 22, 1958	Louis Pondfield	980.00

During the taxable periods of Charles Town here concerned, no additional stock was issued.

During the same taxable years of Charles Town, the officers, all of whom constituted its board of directors, were as follows:

President	Ben Cohen
Vice President	Louis Pondfield
Secretary-Treasurer	Herman Cohen

Ben and Herman Cohen continued to hold these offices in Charles Town during the time the contract between Fairmount and Charles Town, set out below, was in effect. The by-laws of Charles Town provided that the board of directors should have the control and management of the affairs, business, and properties of the corporation. Pondfield was to manage the operation of the racing meets, but important policy questions were to be resolved by a majority vote among Ben Cohen, Herman Cohen, and Pondfield.

An agreement dated May 20, 1958, was entered into between Fairmount and Charles Town which provided as follows:

> THIS AGREEMENT, Made and entered into this 20th day of May, 1958 by and between FAIRMOUNT STEEL CORPORATION, a Pennsylvania corporation (hereinafter referred to as "Fairmount") and CHARLES TOWN INCORPORATED, a corporation created under the laws of West Virginia (hereinafter referred to as "Charles Town").

STATEMENT OF FACTS

Fairmount, through its officers, has for sometime been negotiating with the attorneys representing Helene W. Boyle, in her own right and as Executrix of the Estate of Albert J. Boyle, deceased, for the purchases of the Charles Town Turf Club in Charles Town, Jefferson County, West Virginia, and

WHEREAS, Charles Town has leased the said Charles Town race track for the purpose of operating a racing meet for such number of days as the West Virginia Racing Commission will grant a license to conduct a horse racing meet on the premises, and

WHEREAS, Charles Town does not have the funds, nor the credit, with which to operate the said racing meet, and

WHEREAS, Charles Town has negotiated with Fairmount for the purpose of obtaining the necessary funds for the financing of the said racing meet, and

WHEREAS, Fairmount has agreed to advance to Charles Town a minimum of Four Hundred Fifty Thousand Dollars ($450,000.00) for the financing of the racing meet, including the sum of Two Hundred Twenty-Five Thousand Dollars ($225,000.00) which Fairmount has already advanced for the payment of the rent due pursuant to the said lease, provided that Charles Town agree to operate the said race meet for the benefit of Fairmount and shall receive for its services ten percent (10%) of the net profits for its services thereunder, and if the result of the operation shall

result in a loss, such loss shall be borne by Fairmount; and

WHEREAS, it was understood that the operations of said race meeting shall be conducted pursuant to the terms of this Agreement.

NOW THEREFORE THIS AGREEMENT WITNESSETH, that in consideration of the mutual covenants and conditions herein contained and other good and valuable considerations, the parties agree as follows:

1. Charles Town shall apply for a license to conduct a racing meet at the Charles Town Race Track in Charles Town, Jefferson County, West Virginia for as many days as said club shall be permitted to operate, said meeting to be conducted between days of May 23, 1958 and September 10, 1958.

2. The said race meeting shall be operated by Charles Town, but the profits therefrom shall be for the benefit of Fairmount except that Charles Town receive ten percent (10%) of the profits for its services in the operation of the said racing meet and any loss shall be borne entirely by Fairmount.

3. In consideration of Fairmount receiving ninety percent (90%) of the profits of the said meet, Fairmount agrees to advance all monies necessary for the operation of the said meet, it being understood that Fairmount will advance a minimum of Four Hundred Fifty Thousand Dollars ($450,000.00) to finance said costs of operations of said meet.

4. No interest will be charged by Fairmount for the use of its monies, it being understood that its share of the profits shall be in lieu of all interest charges of any kind.

5. Charles Town shall pay all officers for their services on behalf of both corporations, out of its share of the profits of the meet and no part thereof shall be charged to Fairmount.

6. Full and complete records of all receipts and disbursements in connection with the said meet shall be maintained by Charles Town and no expenditures, out of the ordinary course of business shall be made without the approval of Fairmount. Charles Town shall, at the request of Fairmount, make a complete accounting of all such receipts and disbursements.

7. So long as Charles Town shall be indebted to Fairmount, the officers and directors of Charles Town shall be as follows:

President and Director	Ben Cohen
Vice President and Director	Louis Rondfield
Secretary, Treasurer and Director	Herman Cohen

8. The majority of the above officers shall make all major decisions as to the allocation of income and expenses and in the management of the race meet.

9. Federal and State taxes on income of the respective parties shall be a separate obligation to be borne by each party as to its own income.

10. Charles Town shall carry all necessary insurance to protect itself as well as Fairmount

from all hazards. The cost of said insurance shall be regarded as an expense of operation of the said racing meet.

IN WITNESS WHEREOF, the parties caused this Agreement to be executed the day and year first above written.

This agreement was executed on behalf of Fairmount by Herman Cohen as its president, and on behalf of Charles Town by Louis Pondfield as its vice president. At the time this agreement was executed, Fairmount had allowable net operating loss carryovers of $852,-105.37 from its taxable years ended June 30, 1955, June 30, 1956, and June 30, 1957. An identical agreement was made between Charles Town and Fairmount providing for the financing of the 1958-1959 winter meet during the term of the second lease.

Horse racing meets were conducted at the Race Course by Charles Town during the period June 6, 1958, through September 1, 1958 (hereinafter referred to as the summer meet), and during the period December 18, 1958 through February 7, 1959 (hereinafter referred to as the winter meet).

In connection with the two meets, Fairmount supplied the money necessary to begin the operation of the track, e.g. the payment of rents due under the two leases and the furnishing of cash sufficient to start the pari-mutuel system of betting. Charles Town operated the track. In this connection it applied for and received a license from the West Virginia Racing Commission to conduct the two meets, maintained bank

accounts, secured insurance, became a member of the Thoroughbred Racing Association of the United States, Inc., entered into contracts for promotional and other necessary services, dealt with a catering firm with respect to sales of refreshments at the race track, made all disbursements and paid all expenses relating to the operation of the horse racing meets on checks bearing its name,[3] paid the legal expenses for its organization, filed forms and made payments with various agencies or governmental divisions of the State of West Virginia incident to the conduct of the racing meets, filed Federal excise tax returns and Federal withholding and FICA tax returns and made payments with respect thereto, had stationery and maintained a telephone in its own name, and, after the conclusion of the two racing meets instituted an action and recovered from Helene W. Boyle an alleged overpayment of the rental due in accordance with the provisions of the second lease. The account of Fairmount's advances to and receipts from Charles Town during the racing meets, as shown on the books of both, is as follows:[4]

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[3]Fairmount made two payments by check to Helene W. Boyle under the first lease—the first prior to the incorporation of Charles Town, and the second on the day that Charles Town was incorporated, and one payment to Helene under the second lease. It also made a payment of rent under the second lease to Citizens National Bank of Martinsburg, West Virginia.

[4]An additional amount of $30,000 was received by Fairmount on December 1, 1959, in respect to the second meet, which was credited on Charles Town's books to "Advance from Fairmount Steel Corp." Another amount of $20,466.84 was shown on the cash receipt book of Fairmount as received on June 12, 1959, and credited to an account entitled "Charles Town, Inc.", although it is not shown as a cash disbursement on the latter's books.

Date	Advanced by Fairmount	Received by Fairmount
First Meet		
May 20, 1958	$225,000.00 (1)	
May 22, 1958	15,000.00 (1)	
May 26, 1958	5,000.00	
May 26, 1958	5,000.00	
May 28, 1958	2,025.00	
May 28, 1958	1,000.00	
May 28, 1958	1,000.00	
May 28, 1958	225,000.00	
June 10, 1958		$ 2,025.00
July 5, 1958		100,000.00 (3)
July 12, 1958		140,000.00 (3)
July 24, 1958		130,000.00
August 9, 1958		100,000.00
August 9, 1958		150,000.00
August 20, 1958		150,000.00
September 1, 1958		225,000.00
November 17, 1958		54,612.47
Second Meet		
November 5, 1958	$224,250.00 (2)	
November 5, 1958	63,250.00 (3)	
December 5, 1958	200,000.00	
January 6, 1959		$200,000.00
January 12, 1959		63,250.00 (4)
February 3, 1959		178,250.00 (4)
February 10, 1959		250,000.00 (5)

(1) Paid directly to Helene Boyle. See footnote 3.

(2) Paid to Citizens National Bank of Martinsburg, West Virginia as rent under second Lease.

(3) Payable to Helene Boyle.

(4) Debited to Rent on Charles Town's books, the other receipts after July 12, 1958, except the last being debited on Charles Town's books to "Accounts Payable, Fairmount Steel Corp.".

(5) Debited to rent originally, but on April 30, 1959, $204,000.00 was transferred to an account entitled advance from Fairmount Steel Corporation.

The sums received by Fairmount shown above were generated by the operation of the racing meets.

All income and expenses with respect to both race meets were reflected on the books of Charles Town. By means of a journal entry all the income and expenses, with the exception of officers' salaries, were

transferred to the books of Fairmount. By means of another journal entry, 10 percent of the net profits was allocated to Charles Town. Three sets of these entries were made: the first on June 30, 1958, covering the period of the summer meet through said date which was the end of Fairmount's fiscal year; the second in November 1958, covering the remainder of the summer meet; and the third in the spring of 1959, covering the winter meet. This was done purportedly pursuant to the contracts between the parties, the first of which is set out above in these findings.

The receipts from the operation of both racing meets here concerned were deposited in the regular account of Charles Town in the Peoples Bank of Charles Town, Charles Town, West Virginia, from which account all expenses and charges incident to the operation of both racing meets were paid.

During the period May 28, 1958, through February 17, 1959, deposits in the total amount of $6,523,215.27 were made in the regular account at the Peoples Bank. During the period February 21, 1959, through November 6, 1959, additional deposits totaling $78,234.80 were made in this account.

During the period May 29, 1958, through February 20, 1959, 847 checks were drawn on the regular account totaling $6,270,972.25. During the period February 24, 1959, through June 17, 1960, 65 additional checks were drawn on the regular account totaling $305,115.47.

Fairmount reported on its Federal income tax returns the gross receipts and all the expenses in connection with the operation of the two racing meets. It claimed a deduction for commission expenses representing the 10

percent of the net profits allocated to Charles Town. Fairmount's return for the taxable year ended June 30, 1959, reflected a net profit of $732,299.86 from the racing meets.

On its Federal income tax returns for the taxable periods ended November 30, 1958, and November 30, 1959, Charles Town reported gross receipts in the respective amounts of $64,886.53 and $26,054.87, which amounts represented the 10 percent allocated to Charles Town and which corresponded with the deductions claimed by Fairmount for commission expense. On its Federal income tax return for the taxable period ended November 30, 1958, Charles Town claimed a deduction in the amount of $40,000.00 for compensation of officers as follows:

Louis Pondfield	$25,000.00
Herman Cohen	7,500.00
Ben Cohen	7,500.00

In addition, it claimed a deduction of $1,000.00 for a contribution to the Herman and Ben Cohen Charitable Foundation, Inc. On its Federal income tax return for the fiscal year ended November 30, 1959, Charles Town claimed a deduction in the amount of $20,000.00 for compensation paid to Pondfield. In addition, it claimed relatively small amounts for other deductions, including $200.00 for contributions to the Herman and Ben Cohen Charitable Foundation, Inc. In the balance sheet portion of its income tax return for the fiscal year ended November 30, 1959, Charles Town, Inc. showed net assets of $20,690.92.

The income and expenses of the two horse racing meets here concerned were reported only on the Federal income tax returns of Charles Town and Fairmount. No partnership information returns were filed with the Internal Revenue Service reflecting any of the income or expenses of the two horse racing meets.

On April 24, 1959, a corporation named Charles Town *Properties*, Incorporated (hereinafter referred to as Properties) entered into a contract with Mrs. Helene W. Boyle for the purchase of the Charles Town Race Track (Charles Town, West Virginia) and subsequently purchased the track.

Although *Properties* was formed by persons other than the Cohens and Pondfield, by May 19, 1959, all of the stock of Properties was held by or on behalf of members of the Cohen family, or by Pondfield. Since that time, and until it was sold to outside interests in 1965, Properties owned and operated the Charles Town Race Track.

After the completion of the two racing meets, Charles Town conducted no further business. At some time between May 16, 1960, and May 15, 1961, Pondfield acquired the two shares of Charles Town previously held by Ben and Herman Cohen.

On June 11, 1962, respondent sent to Charles Town, Inc., by certified mail a statutory notice of deficiency determining a deficiency in income tax for the taxable periods May 22, 1958 to November 30, 1958, and December 1, 1958 to November 30, 1959, in

the respective amounts of $258,616.93 and $117,367.57. In a statement attached to the deficiency notice issued to Charles Town, the respondent explained his adjustments for the period May 22, 1958 to November 30, 1958, as follows:

(a) Additional income $497,833.02

It is held that income in the amount of $2,808,220.18, included in the tax return of Fairmount Steel Corporation for the taxable year ended June 30, 1959, constituted additional income to you under the provisions of Section 61 and Section 482 of the Internal Revenue Code of 1954, resulting in additional taxable income in the amount of $497,833.02; computed as follows:

Mutual Dept. Commission	$2,389,657.03
Mutual Dept. Breakage	220,678.86
Programs	21,837.60
Grandstand	51,984.45
Clubhouse	49,208.81
Box Seats	8,958.64
Club House Complimentary	9,878.13
Concessions	33,773.12
Valet Parking	8,824.25
Miscellaneous Income	3,254.80
Federal Admission	164.49
Total Income	$2,808,220.18
Less: Total Expenses	2,308,885.46
	$ 499,334.72
Less: Unknown Difference	1,501.70
Additional Income from Charles Town Race Track	$ 497,833.02

A similar explanation and computation (involving different amounts) was included in the notice with respect to the fiscal year ended November 30, 1959.

On September 5, 1962, Charles Town filed with this Court a petition, docket No. 3517-62, requesting a redetermination of said deficiency. After the trial of the case on June 14 and 15, 1965, this Court determined that there was a deficiency in income tax due from Charles Town for the taxable periods May 22, 1958 to November 30, 1958, and December 1, 1958 to November 30, 1959, in the respective amounts of $258,-

616.93 and $117,367.57; and said decision became final on October 9, 1967.[5] These deficiencies were assessed on April 29, 1966. In June of 1966, the Internal Revenue Service made attempts to collect the deficiencies against Charles Town. At that time Charles Town had no money to pay the tax. Charles Town's only business had been operating the two racing meets and after the completion of these meets it engaged in no further business. Any further attempts by the Internal Revenue Service to collect the deficiencies against Charles Town would have been futile. . . .

C. D. Construction Corporation (hereinafter sometimes referred to as "C. D. Corporation") is a corporation formed under the laws of the State of Maryland. It was incorporated on or about May 1, 1962. C. D. Corporation issued two shares of stock in exchange for each share of Fairmount Steel stock to the shareholders of Fairmount Steel. However, no stock in C. D. Corporation was issued for the Class A voting stock in Fairmount Steel. After this transaction, the stock in C. D. Corporation was held as follows:

Ben Cohen	350 shares
Herman Cohen	350 shares
Charlotte Weinberg	200 shares
Rosalee Davison	200 shares
Nathan L. Cohen Trust	400 shares
Ben and Herman Cohen, T/A Cohen Brothers, a partnership	500 shares
Total	2,000 shares

[5]The decision was reported in a Memorandum Opinion of this Court, T.C. Memo. 1966-15, and was affirmed by the Court of Appeals for the Fourth Circuit, 372 F. 2d 415 (1967). The Supreme Court denied a writ of certiorari from the decision of the Court of Appeals, 389 U.S. 841 (1967).

There have been no changes in the stock ownership to the present time except that the Nathan L. Cohen Trust has been terminated and Nathan L. Cohen became the owner of the stock held by the trust.

On June 30, 1962, Fairmount Steel Corporation was liquidated and its net assets of a value of $253,394.40 were transferred to C. D. Construction Corporation. Thereafter, Fairmount engaged in no further business activity.

Without taking into account any liability for Federal income tax deficiencies due with respect to Charles Town, Inc., the balance sheets attached to Fairmount Steel's Federal income tax returns from its fiscal year ending June 30, 1958 through its fiscal year ending June 30, 1962, show either deficits or small surpluses which were at no time greater than $7,187.63.

OPINION

KERN, *Judge:* Acting under the procedures set forth in section 6901[1] respondent asserted transferee liability against each of the petitioners as transferees or transferees of transferees of Charles Town, Inc. The petitioners concede that Charles Town is liable, pursuant

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[1] SEC. 6901. TRANSFERRED ASSETS.

(a) Method of Collection.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) Income, Estate, and Gift Taxes.—

(A) Transferees.—The liability, at law or in equity, of a transferee of property—

* * * * * * * *

in respect of the tax imposed by subtitle A or B.

(b) Liability.—Any liability referred to in subsection (a) may be either as to the amount of tax shown on a return or as to any deficiency or underpayment of any tax.

to prior court determination, for the total sum of $375,984.50 in income taxes for its taxable periods ending November 30, 1958 and November 30, 1959. It is clear from the record, and petitioners appear to concede this also, that Charles Town has not made and cannot make any payment on its tax liability and that all reasonable means to collect the tax from Charles Town have been exhausted.

Both parties recognize that in determining who is liable as a transferee applicable state law is controlling. See, e.g., *Commissioner v. Stern*, 357 U.S. 39 (1958). The parties appear to agree that a "transferee" under section 6901 includes one who receives property in a transaction which is fraudulent as to the creditors of the transferor under the laws of the states, here West Virginia and Maryland, in which the transfers in question took place.[7] In general terms, under the laws of both states, a fraudulent transfer occurs as to existing creditors of the transferor without regard to any actual intent to defraud when property is transferred to a transferee without consideration "deemed valuable in law" (in West Virginia) or "fair consideration" (in Maryland) being given in return, from a transferor who is insolvent or who is rendered insolvent by that transfer.

In his answer to the petitions filed by the petitioners herein, respondent asserted transferee liability under five separate theories—each theory applying to some, but not all, of the petitioners named herein as transferees. These cases were consolidated for purposes of trial, briefs and opinion. In his original brief, respond-

[7] W. Va. Code Ann. secs. 4-1-2 and 40-1-3 (1966); *Tetrick v. McIntyre*, 110 W. Va. 529, 158 S.E. 788; Md. Ann. Code art. 39B, secs. 1, 3 and 4 (1965).

ent expressly abandoned one of his five theories, but continues to maintain the validity of the four remaining theories under which he asserts transferee liability as to eight of the nine petitioners in these consolidated cases.[9]

Respondent's four remaining theories can be summarized as follows: . . . .

3. . . . Fairmount became a transferee of Charles Town when it received payments under the agreement between these two corporations because it received, without consideration, payments of funds belonging to Charles Town; . . .

4. C. D. Construction Corporation is liable as a transferee of Charles Town to the extent of $253,394.40 plus interest of 6 percent accruing from June 30, 1962. Fairmount was a transferee of Charles Town for the reasons set forth in respondent's third theory, *supra*. Thereafter Fairmount liquidated, transferring without consideration all of its assets to C. D. Construction Corporation on June 30, 1962.

. . . As we understand petitioners' arguments, they can be summarized as follows:

1. Charles Town's liability for the deficiencies in income tax involved herein did not arise until, at the earliest, the time when respondent sent to Charles Town a statutory notice of deficiency as to those taxes (June 11, 1962), because, although the deficiencies were determined under section 61 and section 482, these deficiencies were sustained by the Tax Court and on appeal by the Court of Appeals solely under section 482 without reference to section 61, and section 482

[9] We stated previously as a result of abandoning one of his theories, respondent concedes that there is no transferee liability in the case of Charlotte Weinberg, docket No. 2580-65.

can be applied in a determination of taxes only by respondent. Thus petitioners contend that there was no liability for additional taxes on the part of Charles Town, the alleged transferor, until after the date of the alleged transfers, and consequently the transfer could not be considered as fraudulent under the pertinent statutes of West Virginia since the United States did not become an existing creditor of Charles Town prior to June 11, 1962.

2. Under the terms of the contracts between Charles Town and Fairmount (the first of which is set out in our Findings of Fact), the 90 percent of the profits from the racing meets which Fairmount was to receive in return for advancing all of the funds necessary for the operation of the racing meets constituted the property of Fairmount when received, and consequently there was no *transfer* from Charles Town to Fairmount on which transferee liability may be founded.

3. Even if this Court were to find that the 90 percent of the profits from the racing meets received by Fairmount was at one time the property of Charles Town, still under the terms of the contracts between Charles Town and Fairmount the transfers of the funds from Charles Town to Fairmount were not voluntary but were made for full consideration.

We first decide the issues raised by petitioners in their arguments set forth above.

Petitioners' first argument, based upon certain language in W. Va. Code Ann. sec. 40-1-3 (1966),[10]

[10]Section 40-1-3 provides:

Every transfer or charge which is not upon consideration deemed valuable in law shall be void as to creditors whose

(This footnote is continued on next page)

set forth in the margin below, is that Charles Town had not become subject to the tax liability determined in docket No. 3517-62 (the prior case in which Charles Town's substantive tax liability was determined) and thus no debt had been "contracted at the time" the monies were received by Fairmount from the racing meets, in 1958 and 1959. Citing certain authorities for the proposition that a taxpayer cannot require the application of section 482, and relying on a statement in *Interstate Fire Insurance Co. v. United States*, 215 F. Supp. 586 (E.D. Tenn.), affirmed per curiam 339 F. 2d 603 (C.A. 6) that "the use and application of Section 482 does not result in an enforcible tax consequence until there has been a reallocation resulting in a reassessment of taxes," (215 F. Supp. at 598), petitioners argue that under the law of West Virginia or any other state no obligation for Charles Town's tax liability involved herein could have arisen at least until the determination under section 482 by the respondent in his notice of deficiency dated June 11, 1962.

We think petitioners' argument is without merit. The general rule is stated in 9 Mertens, Law of Federal Income Taxation, sec. 53.37 as follows:

> It is well settled that a transferee is retroactively liable for the transferor's taxes in the year of the transfer and prior years, to the extent of the assets received from the transferor. This is so even though the transferor's tax liability was unknown at the time of the transfer. [Footnote omitted]

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debts shall have been contracted at the time it was made; but shall not, upon that account merely, be void as to creditors whose debts shall have been contracted, or as to purchasers who shall have purchased, after it was made; and though it be decreed to be void as to a prior creditor because voluntary, it shall not for that cause be decreed to be void as to subsequent creditors or purchasers.

See also, e.g., *Scott v. Commissioner*, 117 F. 2d 36 (C.A. 8); *Archie Swinks*, 51 T.C. 13; and *Estate of Harry Schneider*, 29 T.C. 940 (1958). Cases have indicated that the shadow of the inchoate right of the Federal government to tax income is cast continuously upon a business producing income throughout the year (see *Updike v. United States*, 8 F. 2d 913 (C.A. 8, 1925)), and that this shadow may be cast upon the current income of a business even by a retroactive tax imposed by a statute enacted after the close of the taxable year (*Neill v. Phinney*, 245 F. 2d 645 (C.A. 5, 1957)).

Contrary to one of the premises in petitioners' argument, the respondent in his determination of deficiency against Charles Town relied upon section 61 as well as section 482 and this fact was pointed out by both this Court and the Court of Appeals in the *Charles Town* case. Furthermore, both courts made it plain that they considered the income in question to have been earned by Charles Town and to have been the income of Charles Town when earned. In our opinion in that case (25 T.C.M. 77) we said, at p. 92:

> It follows from all of the foregoing that Charles Town earned the income in question. The attempted shifting of this income to Fairmount may properly be corrected by the application of the provisions of section 482 of the 1954 Code.

In affirming us the Court of Appeals in 372 F. 2d 415 said, at p. 422:

> In view of our conclusion that the Tax Court was not clearly erroneous in finding that Charles Town itself earned the income from the two rac-

> ing meets; the Commissioner's allocation of the *total* net income to Charles Town plainly is not unreasonable or arbitrary. Anticipatory agreements designed to prevent the vesting of income in the owners, which was determined to be the essential nature of the intercorporate agreements in the instant case, will be disregarded and the tax assessed against the entity earning the income.

It is clear that both this Court and the Court of Appeals considered that the income in question belonged to Charles Town as it was earned and was taxable to it as earned under section 61, and that any attempt to shift this income to Fairmount by an anticipatory agreement designed to prevent the vesting of this income in the owner of the income (Charles Town) could be corrected by the application of section 482. Thus Charles Town became liable in an unknown amount for taxes on income earned by it at the time it was earned and thus had a debt which had been contracted at the time the transfers were made. This liability did not originate from and was not created by allocation under section 482. This section was availed of to prevent the shifting of this income (and the tax liability thereon) by an anticipatory agreement.

As we have indicated, petitioners' principal reliance in connection with this line of argument is on the statement quoted from *Interstate Fire Insurance Co. v. United States*, *supra*. That case did not involve any question having to do with transferee liability and obviously was not intended by the Court to state the law in this area. In any event it is not controlling in the instant case where the income in question was earned by the transferor and the inchoate liability for taxes thereon arose prior to the transfers.

We are also unable to agree with petitioners' second argument, that the 90 percent of the profits from the racing meets "belonged" to Fairmount and never were the property of Charles Town. Without entering into a lengthy discussion on the collateral estoppel issues raised by the parties, and without again restating the numerous activities undertaken by Charles Town in conducting and operating the racing meets which are stated in our Findings of Fact, we think it is sufficient to state the ultimate conclusions which we draw from those facts: that Charles Town itself earned all of the profits generated from its operation of the two racing meets and that these profits, at least temporarily, "belonged" to Charles Town. *Charles Town, Inc. supra; National Carbide Corp. v. Commissioner*, 336 U.S. 422.

Contrary to petitioners' third argument, in our view the transfer of funds generated by the racing meets from Charles Town to Fairmount under the contract between them was not made as petitioners urge, in return for a "consideration deemed valuable in law" under the law of West Virginia. In support of their argument, petitioners do not directly urge that the advances from Fairmount to Charles Town created a debt obligation (presumably in the nature of an income bond). Instead petitioners rely on the terms of the contract between Charles Town and Fairmount which state that Ben and Herman Cohen were named officers of Charles Town, and the signature of at least one of them was required for checks on Charles Town's regular account. From these facts, petitioners argue that Fairmount's money was provided for specific uses and purposes under specified protections and for specified consideration (90 percent of the profits of the racing

meets). As a consequence, petitioners conclude, the payments from Charles Town to Fairmount were not "voluntary" under applicable West Virginia law, footnote 8, *supra*, and were not merely a return on capital.

We disagree. As this Court has previously pointed out in the *Charles Town, Inc.* case, the advances from Fairmount were not evidenced by any notes or other debt instruments, were made without security, were made without agreement as to a repayment date, and were not repayable at all to the extent that losses were incurred in the racing meets. The portions of the contracts between Charles Town and Fairmount relied upon by petitioners do no more than suggest that Fairmount intended to retain some control as to how its advances were spent; they are not helpful in ascertaining the character of these advances. These advances, made with the intention that Fairmount was to take the risk of loss attendant upon Charles Town's operation of the racing meets here in question, were contributions to capital. See *Motel Corporation*, 54 T.C. 1433 (filed June 29, 1970) and cases cited therein; *Charles Town, Inc., supra.*

Hence we decide that during 1958 and 1959 Charles Town made transfers of its funds to Fairmount and did not receive in return consideration "deemed valuable in law" at a time when Charles Town had become liable for federal taxes arising from its operation of the racing meets from which Charles Town's funds were generated. In determining whether a transferor was insolvent

at the time transfers were made, the transferor's liability for federal income taxes, even if unknown at the time of the transfers, must be taken into account. See 9 Mertens, Law of Federal Income Taxation, sec. 53.32, and cases cited at footnote 86 therein. Applying this rule to the facts herein, it is clear that the transfers made by Charles Town to Fairmount during 1958 and 1959 rendered Charles Town insolvent. Accordingly we conclude that Fairmount was a transferee of Charles Town within the contemplation of section 6901 of the Internal Revenue Code of 1954. . . .

Finally we turn to respondent's fourth theory, that C. D. Corporation was a transferee of a transferee of Charles Town, in that Fairmount was a transferee of Charles Town and C. D. Corporation was a transferee of Fairmount to the extent of the assets transferred by Fairmount to C. D. Corporation when Fairmount was liquidated on June 30, 1962. This theory is sound. Petitioners appear to concede that Fairmount has not made and cannot make any payment on its previously established transferee liability from Charles Town, and all reasonable means to collect the liability from Fairmount have been exhausted. We are convinced that the transaction in which Fairmount transferred all its assets to C. D. Corporation was a fraudulent conveyance under Maryland law, see *Acme Card System Co. v. Remington Rand Business Service Inc.*, 21 F. Supp. 742-747 (D. Md.), and that C. D. Corporation is liable for the income tax liabilities of Charles Town to the extent of the assets received by it as a transferee

of a transferee of Charles Town. The parties have stipulated that the net value of the assets transferred by Fairmount to C. D. Corporation was $253,394.40. The income tax liabilities of Charles Town were in excess of that sum. More specifically we hold that C. D. Corporation became liable for Charles Town's Federal income tax deficiencies to the extent of $253,394.40 on June 30, 1962, plus interest thereon as provided by law. *Archie A. Swinks, supra.*

In accordance with the conclusions we have reached herein,

Decisions will be entered for the petitioners in docket Nos. 2577-68, 2578-68 and 2580-68 through 2585-68.

Decision will be entered for respondent in docket No. 2579-68.

Excerpts From Opinion of the Court of Appeals for the Fourth Circuit in the Charles Town, Inc. Case, 372 F.2d 415.

By the very terms of Section 482 control can be either *direct* or *indirect*. The regulations promulgated under Section 482 define control to include "any kind of control . . . whether legally enforceable, and however exercisable or exercised. It is the reality of control which is decisive, not its form or the mode of its exercise." Treas. Reg. § 1.482-1 (a) (3).

We cannot say that the Tax Court was clearly in error when it determined there was sufficient control of Charles Town and Fairmount by the same interests (the Cohens) to permit the Commissioner's application of Section 482. We agree with the Tax Court that the control exercised by the Cohens by reason of the intercorporate agreements between Charles Town and Fairmount "was only one of several facts . . . by which their actual and effective control of the corporation was acquired and exercised." . . .

Finally, Charles Town objects to the allocation to it of the *entire* net income from the racing meets on the basis that the "allocation of all the fruits to Charles Town alone is directly contrary to the requirement" in Section 482 that "the Secretary or his delegate may distribute, apportion, or allocate . . . between or among . . . ." the controlled businesses. This contention is without merit. The Commissioner has broad discretion in making such allocations and they will not be countermanded unless the taxpayer shows them to be unreasonable, arbitrary, or capricious. *E.g., Spicer Theatre Inc. v. Commissioner*, 346 F.2d 704, 706 (6th Cir. 1965); *Balentine Motor Co. v. Commissioner*, 321 F.2d 796, 800 (4th Cir. 1963); *Aiken Drive-In Theatre Corp. v.*

United States, 281 F.2d 7, 10 (4th Cir. 1960); *Dillard-Waltermire, Inc. v. Campbell*, 255 F.2d 433, 435-36 (5th Cir. 1958). Moreover, this circuit recently has held specifically that the Commissioner may transfer the total income and expenses of one controlled corporation to another under Section 482. *J. R. Land Co. v. United States*, 361 F.2d 607 (4th Cir. 1966). . . .

Excerpts From Findings and Opinion of Tax Court in the Charles Town, Inc. Case, T. C. Memo. 1966-15.

Charles Town was duly incorporated under the laws of the State of West Virginia on May 22, 1958. Its certificate of incorporation provided, in part, that the principal office of the corporation would be located at 1229 Mt. Royal Avenue, Baltimore, Md., which address was the office of the Cohen brothers. The objects for which the corporation was formed were to engage in and carry on the business of operating a race track. The corporation's authorized capital stock was 1,000 shares of common stock of a par value of $10 each. However, only 100 shares were issued by certificates dated May 22, 1958, as follows:

Certificate No.	Issued to	No. of Shares
1	Herman Cohen	1
2	Ben Cohen	1
3	Louis Pondfield	98. . . .

When Charles Town filed with the Racing Commission its application for license to conduct the meets, it was required to file a supporting statement to the application. In the supporting statements, Charles Town represented to the Commission that Charles Town was the applicant; that the name to be used in the operation was "Charles Town Incorporated;" that the race track and racing were to be conducted by a corporation; that Charles Town was that corporation; that its stockholders, officers, and directors were Ben Cohen,

Pondfield, and Herman Cohen; that the Fairmount Steel Corporation had "advanced by loan, or otherwise, the capital invested in the business" in the amount of $500,000; and that Herman Cohen, Pondfield, and Ben Cohen had all been interested in the operation of a race track in Baltimore, Md., called the Maryland Jockey Club, in the capacity of president, vice president, and secretary-treasurer, respectively.

. . .

The respondent, in allocating the income reported by Fairmount from these racing meets to Charles Town, did not act unreasonably, arbitrarily, or capriciously.

Said determination of the respondent was necessary in order to prevent the evasion of taxes and to clearly reflect the taxable income of Charles Town, within the meaning of section 482 of the 1954 Code.

The advances to Charles Town by Fairmount constituted in substance an equity investment.

. . .

It follows from all of the foregoing that Charles Town earned the income in question. The attempted shifting of this income to Fairmount may properly be corrected by the application of the provisions of section 482 of the 1954 Code.[1] [Footnote is a quotation of the section cited].